NPTA MANAGEMENT NEWS AUGUST 1990

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## The Rewards of Working Smarter

The Results of the 1990
Paper Merchant Performance Survey

MN
NPTA MANAGEMENT NEWS

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# PAR - Industrial Performance

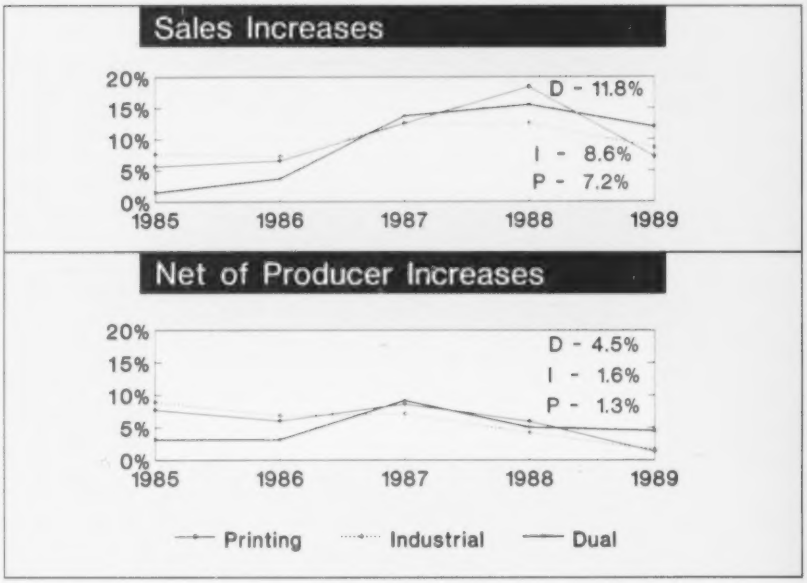
Major industry findings are summarized here from NPTA's member's use of the Management Foresight, Inc.'s PAR

by George Cain, NPTA's

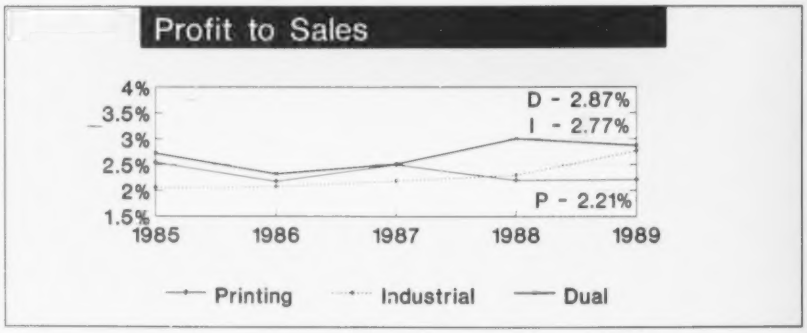
Industrial firms significantly improved their performance, as reflected in NPTA's 1990 PAR (Performance Analysis Report), while printing and dual firms basically maintained prior year performance levels. Industrial firms had relatively low sales increases, but improved their performance on three core PAR Profit Model measures: profit to sales, profit to assets, and profit to net worth. Industrial firms performed better than printing firms on all three measures for the first time in over 10 years and also exceeded dual firms on profit to net worth. Profit figures are Net Profit Before Taxes (NPBT) to allow for realistic comparisons in an industry with substantially different tax loads based on the varieties of company ownership and structure.

This article provides highlights of 1990's *Paper Merchant Performance*, an annual NPTA publication providing extensive prior year and historical data about the paper and plastics distribution industry in the United States. The eight graphs in the article are five-year versions of some of the multi-year graphs included in *Paper Merchant Performance*. All measures cited here are composite averages, which describe how the industry as a whole performed in a given year. *Paper Merchant Performance* also includes additional details about 1989 merchant performance, both on an overall basis and by merchant type (printing, industrial and dual).

1990's *Paper Merchant Performance* itself provides composite results for 1989 industry performance based on data from more than 225 PAR forms submitted by companies to Management Foresight, Inc. (MFI). MFI has been providing PAR reports to NPTA members for 14 years, and NPTA has provided annual operating surveys as a member service for over 50 years.



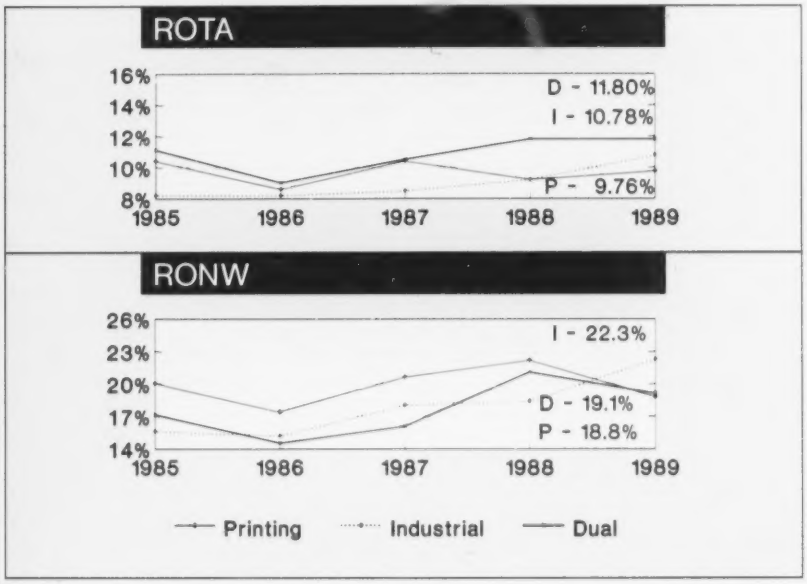

Raw sales increases were lower in 1989, partly reflecting substantially lower increases in prices merchants paid to their suppliers. Dual merchant firms clearly did the best on both dollar volume increases and increases after adjusting for producer price changes, since both printing and industrial merchants had adjusted net volume increases of less than 2%.



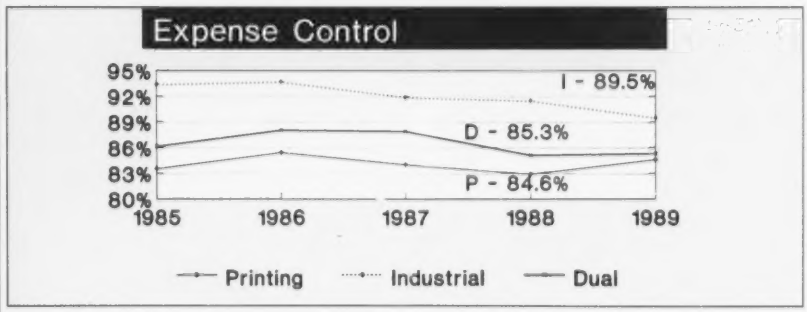

Dual merchants dropped slightly in their Net Profit Before Tax as a percent of sales, but still had the highest performance. Industrial merchants rose substantially, surpassing printing merchants who had a slight drop. This profitability measure, the oldest and simplest of the measures in the PAR Profit Model, is one of three core profitability measures.

# Improves Dramatically for 1990

annual *Paper Merchant Performance*, developed from NPTA (Performance Analysis Report). This report was prepared Director of Research




These two profitability measures are more powerful tools than profit to sales, and it is here that the industrial merchant improvements are most dramatically evident and that the printing merchants show the poorest performance. Return on Total Assets (ROTA) is the most powerful tool, although Return on Net Worth (RONW) is perhaps more well known.




Total operating expenses as a percent of gross margin results parallel the changes in the last two profitability measures. Printing merchants performance was worse, reversing almost all of the previous two years improvement. Dual merchants showed virtually no change, and industrial merchants improved significantly and continued a long-term trend toward improvement.

PAR Profitability Groups. One of the key benefits of PAR is a separate analysis of performance by high, middle, and low profitability groups. Printing firms in 1989 had a much greater spread in profitability measures. The lower profitability group, for example, had profit to sales performance of -1.50%. Printing firms had not had negative profit to sales in the lower profitability group since 1983. This area will take some further examination during 1990.

1990 industrial performance continues strong. NPTA also provides members a Quarterly Business Conditions Report (QBCR) as a "snap-shot" of industry performance during the year. The first quarter QBCR showed industrial performance better than printing performance on Profit to Sales. This performance area also warrants a close look for the remaining quarters of 1990 and in next year's PAR.

PAR provides participating merchants a wide variety of sub-comparisons so that firms can identify their strong and weak points in relation to many different breakdowns, including their sales volume size. Two of the five industrial sales volume groups (under $4.5 million and $6 - $12 million) lagged behind the others on all core profitability measures. The two smallest printing merchant sales volume groups (under $10 million and $10 - $20 million) lagged behind the two larger groups. Among dual merchants, the smallest sales volume size (under $25 million) had the lowest profitability performance.

Other sub-comparisons in PAR include area of the country and industrial product specialization (for industrial merchants) or sales path (warehouse versus direct sales) for printing and dual merchants.

*continued on page 16*

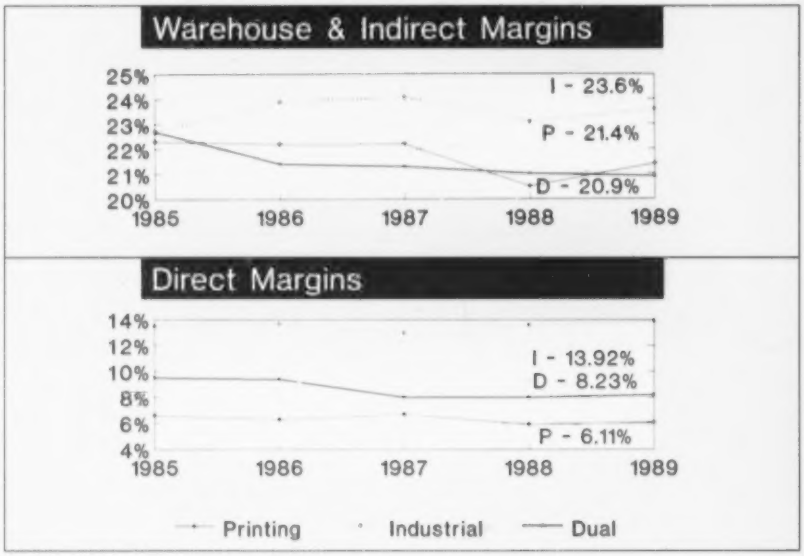
PAR had two new features for 1990 and improved on a new feature from last year. The most dramatic new feature was the early report. Firms filing by the beginning of March received an early summary report of industry performance by April 1. A second new feature was providing a free Executive Summary for all timely filers using the standard questionnaire. The improvement on 1989 was in the PC disk-based questionnaire, EASE, with improvements in ease of use for EASE and separate PC spreadsheet files to help in re-classifications needed for PAR.

PAR is provided to NPTA under contract with Management Foresight, Inc. (MFI) of Columbus, OH. Dr. Peter Mullins of MFI has provided an article for this month on how to manage a company in the midst of a poorer economic situation (see page 18). This is an example of how companies can use PAR measures to manage their businesses more effectively.

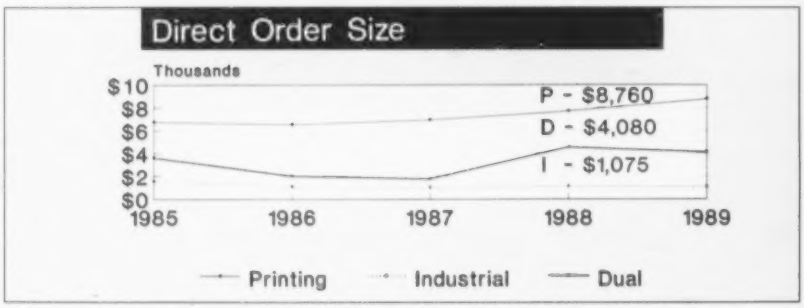
This article highlights some of the results of the 1990 PAR, summarized in NPTA's 60-page *Paper Merchant Performance*. In *Paper Merchant Performance*, but not in this article, are basic measures such as sales and gross profit per employee, per sales department employee, and per outside and inside sales staffs. Similarly, asset and financial management measures such as inventory days and total debt to net worth are included in *Paper Merchant Performance*.

PAR reports, received by individual filing companies, also include a number of considerably more detailed measures. These include sub-expense areas as a percent of gross margin and such detailed areas as average number of warehouse invoice lines per warehouse employee. If a company reported compensation information, PARs also contain information on compensation per various types of employees. Companies can use combinations of these measures, along with the comparisons listed at the end of page 15, to target particular problem or success areas and to improve profitability.

Other measures summarized for this article from *Paper Merchant Performance* are as follows, on gross margins and average direct order size.




Gross Margin percentages show general improvement. Printing paper merchants had noticeable rises in both types of shipments, dual merchants increased their direct margins but had a slight drop in combined warehouse and indirect margins, and industrial merchants showed minimal rises on both margin measures. This favorable margin performance, of course, does not change the long-term erosion of margins which has taken place within the industry.




1989 brings no major surprises in the direct order sizes. Printing merchants showed the only notable rise, but factoring in producer price increases would show virtually no net change over the past several years. Industrial merchant direct order size dropped minimally, and there have been no notable changes since a major drop in 1986. Dual merchants had a drop, but did maintain most of 1988's major increase.

For further information about this article, *Paper Merchant Performance*, PAR or other NPTA research services, contact NPTA's Research Department at 516-829-3070.

# Merchants Play Multiple Roles to Sell Coated Paper

*Distributors serve as a consultant, teacher and banker to satisfy user needs.*

*by Joan Prevete O'Donnell, Senior Staff Writer*

When it comes to selling coated publication papers, merchants wear many hats. Resource, consultant, educator, financier—at some point distributors play all these roles to help customers select the paper that will satisfy their needs.

At the same time, distributors must contend with the advent of new grades, such as supercalendered, and a virtual avalanche of product once new machines come on-stream over the next few years.

Merchants will continue to perform multi-faceted roles, if industry statistics are any indication. According to "Printing/Writing Papers—1989-1998 Outlook," a 1989 research report published by *Pulp & Paper* Forecaster Services/Miller Freeman Publications, San Francisco, U.S. demand for coated paper is forecast to increase by 4.2 million short tons over the current level, reaching 12.1 million tons by 1998. That's a 53% jump in this 10-year period.

Almost all industry experts will tell you that the bulk of coated publication grade is purchased directly from the mill. But how much is open to debate. Research by Jaakko Poyry Consulting, Tarrytown, NY, based on shipment data from the American Paper Institute, shows that 64% of coated pub grades are bought direct, while 36% is bought from merchants. However, a new study of 1,500 magazine publishers, conducted by *Magazine Design & Production*, reveals that close to half buy their paper from merchants. (See box, page 33.)

As well they should, say distributors. That's because wholesalers offer several advantages that mills cannot, due in part to their function and structure.

One is variety. Mills provide only one grade—their own. But because the majority of wholesalers represent a multitude of suppliers, distributors can stock a number of coated sources, thereby acting as a more complete resource for the customer.

As a result, merchants more often than not can ship the needed order regardless of any manufacturing-related crisis that may exist. "We deal with many mills," explained Robert Anderson, executive vice president, general sales manager, Gould Paper, New York City. "While there may be a shutdown at one mill, we can usually substitute product from another."

After all, said merchants, one of the distributor's goals is to get merchandise to the customer. "The end-user obtains a higher level of service with a merchant," said Robert Latzen, vice president, national sales group, JB Papers, New York City. Staffed with salespeople in the field and support help inside, merchants are structured and ready to offer the personalized service that most customers request.

"Unless you're the size of *Time*," said Latzen, "mills are unable to provide the user with the depth of service that we offer."

This "serviceabililty" is a key element in selling coated paper successfully. "Urgency is a factor in this business," pointed out Timothy Shannon, executive vice president, Bradner Smith & Co., Chicago. Indeed, beepers and car phones are two modern tools of the trade that he uses to help keep the relationship between customer and distributor close.

**Act as Advisor**

Because merchants offer such coated

**Major End Uses For Coated Grades**
**U.S. Domestic Shipments in Thousands of Short Tons**

| End Uses | Nos. 1&2 | No. 3 | No. 4 | No. 5 | Coated One-side |
|---|---|---|---|---|---|
| Periodicals | 21 | 117 | 511 | 1,923 | 0 |
| Catalogs | 7 | 545 | 415 | 770 | 0 |
| Inserts & Flyers | 0 | 124 | 217 | 394 | 0 |
| Other Converted Papers | 0 | 6 | 0 | 63 | 21 |
| Commercial Printing | 644 | 130 | 94 | 61 | 43 |
| Books | 9 | 78 | 159 | 53 | 1 |
| Labels | 2 | 9 | 1 | 0 | 339 |

*Source: Forecaster "Printing/Writing Paper - 1989 - 1998"; Miller Freeman Publications Inc. (1987 data)*

## Coated Papers More Popular with Publishers

Of 1,500 magazine publishing executives surveyed, nearly half purchase their coated paper from the merchant community.

That's one of several revealing trends gleaned from the 1990 Paper Trends Survey conducted by *Magazine Design & Production* magazine and published in its June 1990 issue.

According to the published report:

- 54% of responding publishers and corporate officers and 37% of production heads are basically responsible for approving budgets for publication paper;
- 38% of respondents plan to increase paper usage in the next year;
- 55% made no change in paper quality in the past year; however, 25% have upgraded;
- 53% of the responding production managers and 37% of the responding corporate officers/publishers are responsible for recommending the type of publication-grade paper used;
- 52% of production managers and 34% of corporate officers/publishers are accountable for suggesting and/or choosing the paper supplier.

paper variety, they must also act as a consultant to customers to advise them in selecting the appropriate paper for the job. "There are more grades available than ever before. So the merchant plays a role in sorting these out for the end-user," said Edward Kniep III, president of Shaughnessy-Kniep Hawe Paper, St. Louis, MO. "It's not all magazine work."

Indeed, No. 3 coated paper, for instance—the highest quality coated paper that can be called a commodity grade—is used in a number of applications, such as catalogs, books, inserts and direct mail advertising. (See chart, page 32.) The merchant's ability to show and explain the differences between what the manufacturers offer is considered a "value-added service."

Additionally, distributors provide the technical support that's needed. "There may be a question from the customer regarding whether they should run sheetfed versus web," said Shannon. "We help make sure the paper runs" relatively problem-free.

Another role merchants play is that of financier. Most mills insist on payment about 20 days after shipment, a policy that most customers are unable to abide by. By acting as an intermediary, distributors provide other financing arrangements that are more suitable to the users.

At the same time, merchants enable users to get a better handle on costs by offering them the benefits of volume buying. A merchant will often combine an order of, say, 50 tons of paper, with that of, say, 1,000 tons of the same paper, thereby saving the small-order buyer a nice piece of change. "The merchant represents the customer's interests," observed Latzen.

### Better Base Sheet

Whatever hats merchants wear, manufacturers have and will continue to enhance coated publication grades. What's noteworthy, said Latzen, is the recent improvement in the base sheet. "The base sheet is really the critical factor in manufacturing," he explained. The upshot is that the coating's quality is superior not simply on one side, but on both. "You have a much better side-to-side printed sheet."

Quality advancements are also apparent in the paper's brightness and gloss. "Rather than the greyish or reddish white of the past, you tend to see a brighter, blue-white in today's pub grades," cited Anderson of Gould Paper.

Giving coated paper a run for its money, however, in terms of demand, is super-

*See Pub Grades page 34*


**Security & Loss Prevention**

**For The Paper & Plastics Distributor**

A Management Guide for Controlling and Preventing Business Abuse

by Richard P. Fisher

- One in 12 employees will steal from their employers in the future.
- One - third of all employees admit to past thefts from their employers.
- Most wholesale distribution firms will experience some forms of business abuse in addition to theft such as **the use or sale of drugs – payroll violations – computer fraud – cash theft – destruction of audit trails and kickbacks.**

*Security & Loss Prevention for the Paper & Plastics Distributor*, just published by NPTA, addresses the most cost-effective method of fighting business abuse: **Preventing it!**

This guidebook, developed for NPTA by security expert Dick Fisher, describes what to look for, how to prevent losses, and what to do once you've determined that you are indeed a victim of business abuse.

Also, the guidebook contains straightforward, easy to apply principles which you can use to steer your firm towards increased profit and productivity. By carefully studying and implementing the outlined plan, you will be prepared to detect business abuse before it sneaks up on you.

*Security & Loss Prevention for the Paper & Plastics Distributor* is available to NPTA members for **$60** and to suppliers for **$75** (plus **$4** shipping and handling).

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"capital structure"; how you balance funds sources between debt (particularly interest bearing debt) and equity.

Financial risk works very much like operating risk. Firms with no interest bearing debt tend to have more stable earnings. In good times they don't do as well as "highly leveraged" firms (those using a lot of debt financing); but, in tough times they are better off. This is because interest costs tend to act like fixed operating costs. Once a leveraged firm has covered its interest obligations, it gets to keep what is left. And, its equity investment is lower (some of its equity financing was essentially replaced with debt).

Therefore, in good times such a firm will typically achieve a higher return on equity. In bad times such a firm is more likely to lose money. In addition, it runs a higher risk of bankruptcy. Risk and return once again.

**4. Asset Elasticity**

This mouthful refers to how your total asset investment (the left side of your balance sheet) responds to changes in sales. If your asset requirements are very "elastic" and decline at the same rate as sales, then a sales decline will be accompanied by reduced financing requirements. You could use the funds released to pay down debt and reduce your interest costs. This would be very attractive in a recession.

An excellent example of an "elastic" balance sheet is that of a lumber wholesaler who sells carloads of lumber on a direct shipment basis. I am familiar with one such firm that has over 95% of its assets in accounts receivable. When the firm's sales declined from $60 million to only $30 million, accounts receivable also declined from $8 million to $4 million. The $4 million that was collected and not reinvested in receivables was used to pay down debt. As a result, the firm's financial leverage multiplier declined from 3.8 at the peak of the building cycle to only 1.5 at the trough, exactly what you would like to have happen.(2)

In contrast to the lumber wholesaler described above, the typical metal service center has a significant investment in fixed assets and a relatively low inventory turnover. Thus, its asset elasticity is much lower. As a result, the average service center is not able to decrease its asset investment proportionately when sales decline. And, its financing needs (and interest costs) tend to remain high even when business slows. The average paper merchant is probably somewhere between the two extremes above. On the plus side:

- Most paper merchants don't have very large investments in fixed assets.
- They manage their inventory effectively and so can react more quickly to weaker demand.
- Their average collection period is relatively short and may reflect lower risk account (and, then again, it may not, depending on the firm's market emphasis.)

**Footnotes:**

*1. You can develop your own financial planning model using a spreadsheet, or buy one of the many already available. Roger Harvey's model costs $250. You can call him at 614-421-1101 (I have no economic interest in the model).*

*2. For those still not comfortable with the financial leverage multiplier, remember that it is just "one more than the debt-equity ratio." In the example above, the debt-equity ratio declined from 2.8 to 0.5.*

*Part two will continue in September* MN.

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calendered paper. Supercal, the majority of which is made in Europe, competes primarily with No. 5 lightweight coated paper. Prices for both types are converging. And that might change the picture for coated. "There's only so much of the pie to go around," said Shannon.

But at this point, supercal's value has its limits. Industry experts maintain that SC's ink hold-out has not reached that of coated grades. As a result, "SC is used in areas, such as rotogravure, where critical printing is not absolutely necessary," said Latzen.

**Old Signs No Longer Exist**

While the statistics for coated paper demand over the next decade are upbeat, those on the street are finding that their crystal balls have become cloudy. "The old indicators for demand don't seem to work anymore," noted Latzen. For instance, years ago a downturn in the U.S. economy would usually affect the demand for paper. Today, thanks to new markets and uses, that may not always be the case, he explained.

Another factor that prohibits demand predictions is that, for the most part, the printing community is no longer keeping a large inventory of paper as it did in the past. Back then, as demand increased, printers stored as much paper as they could, said Latzen. But in the '90s, most of these firms, stymied by exorbitant costs, are carrying little or no inventory—relying instead on just-in-time delivery.

Complicating the supply-demand issue even further is the fact that over the next three years, at least three suppliers—Consolidated Papers, S.D. Warren and Champion International—are unleashing three new machines for the making of coated papers. This, industry observers noted, will have a dramatic effect on pricing and margins.

**Do the Basics**

Nevertheless, distributors can remain successful in this market niche if they "continue to do the basics," said Kniep of SKH, that is, informing customers of the latest products and trends and satisfying their needs quickly.

But only a handful of merchants are up to the challenge. "This is a segment of the merchant business where only a few are committed to it," observed Charles White, president, Monarch Paper, Houston. "The successful ones are those that specialize and are devoted to this area."■